IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1904

DANIEL N. HOLDEN and LIZZIE HOLDEN, Bankrupts,
Petitioners,
vs.
J. A. STRATTON, Trustee.

No. 209

On Writ of Certiorari to the United States Circuit Court of Appeals for the Ninth Circuit.

STATEMENT OF THE CASE.

In January, 1901, The First National Bank of Seattle, Washington, filed in the United States District Court, for the District of Washington, Northern Division, its petition setting forth that it was a creditor of Daniel N. Holden and Lizzie Holden, his wife; that said Holdens were insolvent, and praying that they be adjudged to be bankrupts within the purview of the Acts of Congress relating to bankruptcy (Record, p. 9).

Said Holden and wife, in answer to said petition, (Record, p. 12) admitted their insolvency and prayed to be adjudged bankrupts, and James A. Stratton, Esq., was duly elected and qualified as trustee in bankruptcy of their estate

under the laws of the United States. Subsequently petitioners claimed among other property exempt under the state law certain policies of life insurance which had been delivered to the trustee (Record, p. 9). These policies were issued on the 15th of June, 1894, by the Northwestern Life Insurance Company of Milwaukee, Wisconsin, and are numbered respectively 206,283 for $5,000.00; and 303,921 for $2,000.00. In both, Daniel N. Holden is the insured and Lizzie Holden, his wife, is named as the beneficiary (Record, p. 4). (The policies, according to the claim of the trustee, if allowed, have a present combined cash surrender value of about $2,200.00. That they have any cash surrender value, we deny. This is one of our contentions).

The Referee in Bankruptcy, Hon. John P. Hoyt, ex-Chief Justice of the supreme court of the State of Washington, ruled on June 17th, 1901, that said policies were not exempt, but passed and were vested in the said trustee. But the referee in the certificate disallowing the exemption added: "In justification of said ruling, I desire to state and certify, that if this question had been in my opinion, an open one in this circuit, I should have held that said policies of insurance were, under the term of said bankrupt laws, exempt to the bankrupts and did not pass to the trustees; but the court of appeals of this circuit, having in the case of In re Scheld, 104 Fed. 870, passed upon this question and there being in my opinion no reason for distinguishing the case at bar from the above cited case, I feel bound to decide and certify as above stated. As referee I do not feel that I would be justified in attempting to distinguish that case from this one, nor to make a ruling without regard thereto even although I

am satisfied that the court, in diciding said case improperly interpreted the bankrupt law of the United States."

On July 16th, 1901, the district court, after an exhaustive presentation of the issue by counsel for petitioners and said trustee, entered an order setting aside the action of the referee and directing that said policies be turned over to petitioners as exempt (Record, p. 3). Whereupon, said trustee applied to the United States circuit court of appeals for the ninth circuit for a revision and review of the said order of the district court to the end that the claim of exemption of petitioners be denied and the action of the lower court corrected (Record, p. 9).

On January 16th, 1902, the decree of the said circuit court of appeals was filed, setting aside the said order of the district court and declaring said policies to be not exempt (Record, pp. 18—21).

The petition for a writ of certiorari herein was granted on the 22d day of March, 1904 (Record, p. 25).

SPECIFICATION OF ERRORS.

It was error to find and hold that the life insurance policies issued to Daniel N. Holden on the 15th day of June, 1894, and numbered respectively 206,383 and 303,921, for the respective sums of $5,000.00, and $2,000.00, were not exempt under the bankrupt law.

It was error to order that the decree of the district court allowing said bankrupts' claim of exemption, be set aside.

It was error not to find and hold that the said policies of insurance and the proceeds thereof were exempt under the

bankrupt act from all claims of the creditors of said bankrupts.

ARGUMENT.

In the year 1897, the legislature of the state of Washington enacted, "That section 1 of an act entitled 'An act exempting the proceeds of life insurance from liability for debt, and declaring an emergency,' approved March 20, 1895, is amended as follows:

"Section 1. That the proceeds or avails of ALL life and accident insurance shall be exempt from all liability for any debt.

"Section 2. An emergency exists, and this act shall take effect immediately."

Laws of Washington 1897, page 70.

It is stipulated by petitioners and respondent, "That all and every of the liabilities of said bankrupts were made and contracted between the first day of September, 1900, and the first day of December, 1900 (Record, p. 11).

By Section 6 of the bankrupt law of 1898, it is provided that bankrupts shall have the exemptions which are prescribed by the state law of their domicile. Section 70 of the act provides, under a proviso, that when any bankrupts shall have any insurance policy which has a cash surrender value, the policy shall pass to the trustees as assets.

The absolute and unqualified rule of exemption as declared

in section 6 is not negatived by the proviso in section 70, and the Holden policies are exempt.

Steele v. Buel, 104 Federal Reporter, p. 968.

Pulsifer v. Hussey et al, 54 Atlantic Rep. 1076.

The rule of exemption in section 6 prevades the whole act.

Lockwood v. Exchange Bank, 23 Supreme Court Rep. 751.

The honorable circuit court of appeals for the ninth circuit in *Re Scheld,* 104 Fed. Reporter, 870, being the decision referred to by Referee Hoyt, in his said certificate in this cause to the district court, and by his honor, Justice McKenna, in the decision of this cause in the court of appeals, held that the proviso in section 70 is a specific limitation on section 6, and that the title to life insurance policies having a cash surrender value vests in the trustee, notwithstanding the exemption under the state laws.

In the Scheld case, the court of appeals does not make any extended analysis of the bankrupt act, but simply lays down the broad proposition that "the fact that this special clause is preceded by the word 'provided' does not in any sense limit the force thereof," citing *Railroad Co. v. Smith,* 128 U. S. 174.

But that part of Railroad Co. v. Smith, in regard to the term "provided" is mere *obiter dictum,* and was in no way necessary to and was not considered as a ground for the

decision. And certainly the learned court in the Scheld case did not take into consideration the policy of congress to always exempt to debtors and bankrupts the property exempt to them by the state law; nor the rule of law requiring them to give to the bankrupt act such a construction as would harmonize and give effect to each and every part thereof.

Pulsifer v. Hussey, supra.

Lockwood v. Exchange Bank, supra.

It seems a forced construction to say that "giving to the words used in section 70 their usual and fair import, they clearly declare that policies of insurance of the character of that in issue in this case pass to the trustee as part of the assets of the bankrupt."

In the Scheld case, the court cites in *Re Lange* (D. C.) 91 Fed. 361, in support of their position, that the policies were not exempt. The doctrine in the Lange case was also urged but overruled in *Steele v. Buel*, supra, for as is therein stated "the district court, somewhat doubtingly, confirmed the ruling of the referee, on the authority of a previous decision of that court in *Re Lange* (D. C.) 91 Fed. 361, and thereupon the bankrupts appealed the case to this court." Judge Shiras, who decided the Lange case, afterwards in *Re Steele*, 98 Fed. 79, said: "I freely admit that the question (as to said exemptions) is not free from doubt." This shows an additional weakness in the position taken by the court in *Re Scheld*, which case is made decisive of the case at bar.

Instead of enlarging the rights to property in the trustee, the *proviso* further qualifies and limits them.

Pulsifer v. Hussey, supra.

It has always been the policy of congress to exempt to debtors and bankrupts the property exempt to them by the state law. From the organization of the federal courts under the judiciary act of 1789, the law has been that creditors suing in those courts could not subject to execution property of their debtor exempt to him by the law of the state.

Steele v. Buel, supra, and cases there cited.

Exemption statutes should be liberally construed.

Puget Sound, etc. Packing Co. v. Jeffs, 11 Washington, 466.

In Re Kane, 127 Fed. Rep. 552.

The constitutional requirement of uniformity is not violated by section 6 of the bankruptcy act.

Hanover National Bank v. Moyses, 22 Supreme Court Reports, 857.

A court of bankruptcy is a court of equity, seeking to administer the law according to its spirit, and not merely by its letter.

In *Re Kane*, supra.

The state law, must, independently of other authority, control the decision in this case.

In Re Wilson, 123 Fed. Rep. 20 (C. C. A. 9th circuit).

But for the sake of argument, suppose the proviso in section 70 limits the rule of exemptions as laid down in section 6. The question then arises, do the two Holden policies

come within the definition of policies having a cash surrender value? The term "cash surrender value," as used in the bankrupt act, means the cash value—ascertainable by known rules—of a contract of insurance abandoned and given up for cancellation to the insurer by the owner, having contract right to do so.

In Re Welling (U. S. C. C. A.) 113 Fed. 189.

Pulsifer v. Hussey, supra.

In the case at bar, policy No. 303,921, for $2,000.00, is a non-participating paid-up policy, payable in case of death to Lizzie Holden, the beneficiary therein named. The policy does not contain any provision as to surrender, nor options. In other words it does not come within the above definition. For as was said in Re Welling (supra): "The surrender of the proviso is not the subject of negotiation or agreement, but of right. The proviso does not include those policies where the right to surrender is not given by the contract." And in the present case, as in the Welling case, surrender could only be legally accomplished through agreement with the company by the joint action of Holden and his wife. There exists no right in either the wife or husband, jointly or singly, to surrender. It could only be done by the joint action of the two by agreement with the assurance society. But in the Welling case the court went further and found that while the policy did not fall within the terms of the proviso, the bankrupt had property therein which passed to his trustee, for by the terms of the policy in that case the bankrupt was entitled to receive at the end of the tontine period the cash payment stipulated in the contract. But in the case at bar, the policy under consideration (No. 303,921) does not give any vested

contract rights as to any cash payments upon any dates certain, no payment being stipulated for except the $2,000.00 upon the death of the insured. Hence, in Re Welling directly sustains our position as to the exemption of said policy No. 303,921.

Let us now consider the other Holden policy, No. 206,383, for $5,000.00. The company by this contract agrees that, upon the payment of $233.80 on the 21st day of May in every year during the first ten years from May 21st, 1890, it will pay the said insurance to Lizzie Holden, wife of D. N. Holden, the insured, within sixty days after due proof of the fact and cause of the death of said insured. The premiums have all been paid. The policy contains the statement that it is issued on the Semi-Tontine Plan, and its Tontine Dividend Period is twenty years, and that the policy shall share in the surplus, according to company's usage, at each distribution after twenty years from May 21, 1890. There is endorsed upon the policy certain options which the insured may have upon the completion of the Tontine Dividend Period. The policy does not provide for any cash surrender value. Therefore, according to the Welling case, it does not fall within the provisions of section 70 of the bankrupt act relating to a cash surrender value. But in that case, the court held that though the policy had no "cash surrender value," within the meaning of the proviso, it had an actual value, which constituted a right of property in the bankrupt, and which could have been transferred by him, and therefore passed to the trustee. In the Welling case the law of the state of the domicile of the bankrupt *does not* exempt policies of insurance. But we review it here to show to your Honors that even where the question as to the construction to be given to the

proviso is not raised, there is much difference of opinion as to just what life insurance policies do pass to the trustee, and that even giving the construction to the proviso contended for by the trustee, policy No. 303,921 is exempt, as not having a cash surrender value. After careful study of the case of in Re Welling, we are firmly convinced that the dissenting opinion of Circuit Judge Grosscup in that case states the law correctly, and that this Honorable Court can directly see the force and logic of his position, we cite therefrom the following:

"* * * Another term of the option is (as in the case at bar) that the election shall be by the husband himself. No one else can stand in his place, or exercise the option under the circumstances and sense of obligation that would influence him. * * * I am of the opinion that a fair interpretation of the spirit of the policy would disallow the exercise of the option of Welling until the day for its exercise had arrived, and would then disallow its exercise, unless it be by the judgment of Welling himself. Such an interpretation, of course, forbids the view that the option is transferable in advance—in this case six years in advance—or was subject to levy by creditors."

If in the Welling case the option is not transferable six years in advance, how much more reason there is that in the case at bar, it should not be transferable ten years in advance, and especially as no definite sum is guaranteed in the Holden policy No. 206,383 to be paid upon its surrender at the completion of the Tontine dividend period.

It may not be out of place to refer here to the case of *In Re Heilbron's Estate*, 14 Wash. p. 536, cited by Justice

McKenna in the opinion filed in the circuit court of appeals in this case. In the Heilbron case the policies were made payable to Heilbron's executors in case of his death. By the terms of his will, his brother W. C. Heilbron was bequeathed the sum of $5,000.00. Other legacies were bequeathed by the deceased. The said W. C. Heilbron assigned his interest to the Guarantee Loan and Trust Co. of Seattle. George H. Heilbron died insolvent, and was insolvent at the time of making the will. In that case, according to the opinion of the court, the policies of insurance belonging to the estate were liable for the debts of the deceased, as these debts were incurred prior to the enactment of the law exempting the policies of life insurance from liability for debt. The Holden policies are not payable to the executors of the estate, and the debts were not incurred prior to the enactment of the life insurance exemption law. In the Heilbron case, the estate of the deceased became the benificary, and afortiori the creditors. In this case the wife is made the beneficiary and the policies are only payable upon conditions precedent, or death; and these conditions precedent require the concurrence of three wills, and these conditions or concurrence may be in the future, in fact must be in the future. Three minds must agree before anything can be had from the policies until the consummation of a time certain and fixed in the policies. Can the creditors in this case, through their trustee, force a concurrence of minds? Can they compel the insurance company, against its will, to shorten the time fixed in the policies? In other words, can the trustee destroy the object of the insurance and so destroy or annul the benevolent act of the state?

Should this Honorable court hold that the policies here in issue are not exempt under the bankrupt act, the question

would then arise: has congress the power to abrogate state exemption laws?

Whatever is not conferred in the constitution is withheld, and belongs to the several states, or to the people thereof.

Cooley's Principles of Constitution Law, p. 29

Any enactment of congress which is opposed to the provisions of the constitution, or is not within the grant of powers made by it, is unconstitutional.

Idem. p. 31.

Hence, as no such grant of power has been made to it, congress has never claimed the right to abrogate state exemption laws.

In Re Beckerford, 1 Dillon 45.

Nor is any such right properly an incident to an expressed power in the constitution, and necessary to its execution.

But to give the exemption phase of the bankrupt act the construction contended for by the trustees, and as laid down by the circuit court of Appeals, would in effect be giving to congress the unauthorized power to abrogate and annul state exemption laws.

We beg your Honors' indulgence while we discuss this feature of the case a little further. Under Art. 1, Sec. 8, among other powers, congress has the following: "To establish an uniform rule of naturalization, and uniform laws on the subject of bankruptcy, throughout the United States." And here let us not forget that ours is a Republican form of

government, or in other words, an agreement of the people, for the people, and by the people—a constitutional democracy.

This is implied by articles 9 and 10 of the amendments. The constitution reads thus: (Art. 9)—"The enumeration in the constitution, of certain rights, shall not be construed to deny or disparage others retained by the people." (Art. 10.)—"The powers not delegated to the United States by the constition, nor prohibited by it to the states, are reserved to the states respectively, or to the people." Here then is a limitation on the powers of congress. It seems to us it cannot be successfully argued that the state has not reserved the power to legislate, within its own sovereign domain, for the people claiming citizenship, personal and property rights within the commonwealth. The state in its beneficence has seen proper to exempt among other property, from liability for debt, life insurance.

"That the power to tax involves the power to destroy; that the power to destroy may defeat and render useless the power to create; that there is a plain repugnance in conferring on one government a power to control the constitutional measures of another, which other, in respect to those very measures, is declared to be supreme over that which exerts the control,—are propositions not to be denied."

Cooley on Principles of Constitutional Law, 61.

McCulloch v. Maryland, 4 Wheat. 316, 431.

"It is true that taxation does not necessarily and unavoidably destroy, and that to carry it to the excess of destruction would be an abuse not to be anticipated; but the very

power would take from the states a portion of their intended liberty of independent action within the sphere of their powers, and would constitute to the state a perpetual danger of embarrassment and possible annihilation. The constitution contemplates no such shackles upon state power, and by implication forbids them."

Cooley, Id. p. 62.

The power of the states to protect the lives, health, and property of their citizens, and to preserve good order and public morals is a power originally and always belonging to the states, and not surrendered by them to the general government.

United States v. E. C. Knight Co., 156, U. S. p. 1.

If then the power of the state to protect the lives, health, and property of its citizens, and to preserve good order and public morals, is a power originally and always belonging to the state and has not been surrendered by it to the general government, how will congress undertake within the constitution to annul and abrogate a law exempting the property of a citizen from liability for debt?

Again we put the question to your Honors, has congress the power to abrogate and destroy the exemption laws of a state? Is that not a law regulating property rights?

Respectfully submitted,

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